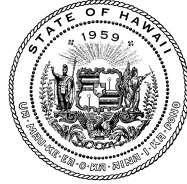


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MARIA E. ZIELINSKI
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JOSEPH K. KIM
DEPUTY DIRECTOR

To: The Honorable Sylvia Luke, Chair
and Members of the House Committee on Finance

Date: March 3, 2016
Time: 2:00 P.M.
Place: Conference Room 308, State Capitol

From: Maria E. Zielinski, Director
Department of Taxation

Re: H.B. 2042, H.D. 1, Relating to Water Conservation.

The Department of Taxation (Department) appreciates the intent of H.B. 2042, H.D. 1, and provides the following comments for your consideration.

H.B. 2042 provides a refundable income tax credit for fifty percent of the cost of a residential water conservation system, up to a maximum of \$1,000, with an aggregate cap of \$2 million per year. The bill is effective upon approval and applies to taxable years beginning after December 31, 2016.

The Department appreciates that its suggestion to amend the definition of "residential water conservation system" was adopted by the House Committee on Energy and Environmental Protection. The Department also notes the following:

First, the Department notes that it generally recommends non-refundable tax credits because refundable tax credits create the potential for wrongful claims and abuse.

Second, the Department notes that aggregate caps are very difficult for the Department to administer and often result in uncertainty for taxpayers. Accordingly, the Department requests that the credits be certified by another State agency if the Legislature intends to impose an aggregate cap on the total amount of claims.

Finally, the Department notes that this bill will require a new form and system programming and requests that the bill apply to taxable years beginning after December 31, 2017.

Thank you for the opportunity to provide comments.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

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SUBJECT: INCOME, Credit for Residential Water Conservation System

BILL NUMBER: HB 2042, HD-1

INTRODUCED BY: House Committee on Energy & Environmental Protection

EXECUTIVE SUMMARY: Proposes an income tax credit for a residential water conservation system. The proposed credit would result in a subsidy of such devices as it would merely grant a tax credit for such purchase irrespective of a taxpayer's need for tax relief.

BRIEF SUMMARY: Adds a new section to HRS chapter 235 to allow taxpayers to claim a tax credit for a residential water conservation system where the cost is incurred and paid during a tax year. The amount of the credit shall be 50% of the cost of the system incurred and paid during the taxable year up to a maximum of \$1,000.

Defines "residential water conservation system" as (1) the equipment and supplies used to construct a system for the capturing, infiltrating, or utilizing of rainfall from roofs, constructed catchment surfaces, or other hard surfaces on a residential property; or (2) the equipment and supplies used to construct a system for the collection and reuse of gray water, as defined in HRS section 342D-1, on a residential property.

If a deduction is taken for the system under Internal Revenue Code section 179, no tax credit shall be allowed for that portion of the system costs for which the deduction was taken. The basis of the system for depreciation purposes will be reduced by the amount of credit allowable and claimed, and no deduction for state income tax purposes shall be allowed for the costs for which the credit is claimed.

Credits in excess of a taxpayer's income tax liability may be applied to subsequent income tax liability until exhausted. Requires all claims for the credit to be filed on or before the end of the twelfth month following the close of the taxable year. The director of taxation may prepare the necessary forms to claim the credit and may require the taxpayer to furnish information to ascertain the validity of the claim for the credit. The director may adopt rules under chapter 91.

EFFECTIVE DATE: Upon approval, applies to taxable years beginning after 12/31/16.

STAFF COMMENTS: It appears that this measure is proposed to encourage taxpayers to purchase residential water conservation systems by allowing taxpayers to claim a 50% tax credit for the costs of a system, up to a maximum of \$1,000 (presumably per year).

Lawmakers need to remember two things. First, the tax system is the device that raises the money that they, lawmakers, like to spend. Using the tax system to shape social policy merely throws the revenue raising system out of whack, making the system less than reliable as there is no way to determine how many taxpayers will avail themselves of the credit and in what amount. The second point to remember about tax credits is that they are nothing more than the

expenditure of public dollars, but out the back door. If, in fact, these dollars were subject to the appropriation process, would taxpayers be as kind about the expenditure of these funds when students are roasting in our schools, or when there isn't enough money for social service programs?

Utilizing tax credits other than to alleviate an excessive tax burden cannot be justified and is of a questionable benefit relative to the cost for all taxpayers. If lawmakers want to encourage the use of water conservation systems by reducing the cost of such systems, then a direct appropriation to subsidize that cost would be more accountable and transparent.

Furthermore, the additional credit would require changes to tax forms and instructions, reprogramming, staff training, and other costs that could be massive in amount compared to the loss in revenue from the credit. A direct appropriation, or even a program similar to the way we currently subsidize energy efficient appliances, may be a far less costly method to accomplish the same thing.

Digested 3/3/2016